

General Information Letter: Nexus determinations cannot be made by letter ruling.

September 9, 2005

Dear:

This is in response to your letter dated August 1, 2005 that was forwarded to me to address the income tax issues presented in your letter. It is my understanding that you will receive a letter under separate cover from our sales tax division regarding your questions relating to Retailers' Occupation Tax and use tax. Your letter states as follows:

I would like to request a general information letter in response to the following issues.

Specifically, I am inquiring as to whether any of the following scenarios would establish sufficient nexus to subject a foreign corporation to Illinois income tax and/or require registration for and collection of Retailer's Occupation Tax or use tax.

The company in question (AAA) is incorporated under the laws of Connecticut. AAA sells hockey jerseys at retail through an internet site. Basic jerseys are purchased from a vendor located outside Illinois. An unrelated Illinois business (BBB) performs embellishment services (stitching of letters and/or numbers) on the jerseys prior to them being shipped to the end customer. The letters and numbers being stitched on the jerseys are provided by BBB. AAA does not have any other property or employees located in Illinois. All shipments are made via common carrier.

Scenario 1: AAA orders jerseys from its vendor which are drop shipped directly to BBB in Illinois. BBB stores the jerseys until AAA receives an order for a jersey at which time BBB performs its alterations and drop ships the jersey to the end customer on behalf of AAA.

Scenario 2: AAA orders jerseys from its vendor which are shipped to and stored by AAA in Connecticut. Upon receiving an order for a jersey, AAAA ships the jersey to BBB in Illinois who performs alterations on the jersey and drop ships the jersey to the end customer on behalf of AAA.

Scenario 3: Same as scenario 1 except that, instead of BBB drop shipping the jersey to the end customer, the jersey is shipped to AAA in Connecticut who then ships the jersey to the end customer.

Scenario 4: Same as scenario 2 except that, instead of BBB drop shipping the jersey to the end customer, the jersey is shipped to AAA in Connecticut who then ships the jersey to the end customer.

Scenario 5: AAA purchases jerseys directly from BBB which are then drop shipped by BBB to the end customer on behalf of AAA.

Please provide separate guidance on each of the above scenarios based on whether the jersey is shipped to the end customer in Illinois vs. out of state.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL").

The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.tax.illinois.gov/LegalInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 502(a) of the Illinois Income Tax Act ("ITA," 35 ILCS 5/101 et seq.) describes when an Illinois income tax return is required. Pursuant to Section 502(a), an Illinois income tax return is required in two situations. The first situation is when a taxpayer is liable for Illinois income tax. The second situation is, in the case of a corporation qualified to do business in Illinois, when the taxpayer is required to file a federal income tax return, regardless of whether such person is liable for Illinois income tax.

Section 201 of the Illinois Income Tax Act ("ITA"), 35 ILCS 5/101 et seq., imposes a tax measured by net income on corporations for the privilege of earning or receiving income in this State. The Due Process and Commerce Clauses of the Federal Constitution limit the power of States to subject foreign corporations to tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id. You may be familiar with the New York case of Orvis v. Tax Appeals Tribunal, 86 N.Y.2d 165, 654 N.E.2d 954 (1995) where the court found that four visits to nineteen customers in one year was enough to allow the state to tax a Vermont wholesaler.

Whether your client is liable for Illinois income taxes depends on whether there is sufficient nexus between Illinois and your client's business. Enclosed please find a copy of 86 Ill. Admin. Code 100.9720 that specifically covers the issue of nexus. Section 100.9720 provides a helpful guideline when confronted with the question of whether a taxpayer has sufficient nexus with Illinois. Specifically, section 100.9720(c)(4) provides a list of certain activities that constitute sufficient nexus to subject a taxpayer to taxation by Illinois and section 100.9720(c)(5) provides a list of activities that would not subject a taxpayer to taxation by Illinois.

Using 86 Ill. Admin. Code 100.9720 as a guideline, based on the brief facts provided in your scenario 1 and 3, both of these factual situations indicate that BBB "stores the jerseys until AAA receives an order for a jersey." BBB in effect acts as an independent contractor that stores goods for AAA. Because the goods are stored in Illinois and continue to belong to AAA, AAA is no longer protected by PL 86-272 pursuant to section 100.9720(c)(6)(C). Scenarios 2 and 5 indicate that BBB acts as an independent contractor for AAA in shipping completed goods to AAA's customers. Using an independent contractor for shipment and delivery purposes will allow AAA to continue its protection under PL 86-272. Assuming that AAA's customers are not from Illinois, the facts in scenario 4 do not support an argument that there is sufficient nexus between AAA and Illinois to subject AAA to Illinois income taxes.

Should AAA be found to have sufficient nexus with Illinois (as in scenarios 1 and 3), AAA will be required to file an Illinois income tax return and must register with the state of Illinois and the Illinois Department of Revenue. All inquiries regarding how to register as a foreign corporation should be directed to the Illinois Secretary of State at the following address:

Office of the Illinois Secretary of State
Department of Business Services
Howlett Building, Room 328
Springfield, Illinois 62756
(217) 782-7880

Enclosed please find a copy of Form REG-1, which is used to register businesses with the Illinois Department of Revenue.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax